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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

No. [redacted] 171

FEDERATED DEPARTMENT STORES, INC.,

Appellant,

—v.—

LAWRENCE E. GEROSA, as Comptroller of THE CITY OF NEW YORK,

Appellee.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

STATEMENT AS TO JURISDICTION

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Appellee.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

STATEMENT AS TO JURISDICTION

Appellant, pursuant to United States Supreme Court Rules 13(2) and 15, files this statement and contends that the Supreme Court has jurisdiction of a direct appeal to review the final judgment of the Court of Appeals of the State of New York, a state court of last resort, and that the Supreme Court should exercise such jurisdiction in this case.

Opinions Below

The original determinations below assessed so-called Business Tax Deficiencies against appellant of $35,925.13 principal and $19,285.37 interest and penalties for the years 1953-1958 (R. 34, 41). The determinations were made by the appellee as Comptroller of the City of New York, unaccompanied by any findings of fact except on the question of penalties (R. 35-40, 42-47), not relevant here. Judicial review in the first instance was had in the Appellate Division of the Supreme Court of the State of New York, First Judicial Department, which, on May 7, 1964, unanimously confirmed the Comptroller's determinations (R. 325-326). That court's decision, rendered without opinion, is reported at 21 A. D. 2d 751, 251 N. Y. S. 2d 900.

The Court of Appeals affirmed, one judge dissenting. The majority and minority opinions are set forth in Appendix A to this statement. Those opinions are reported at 16 N. Y. 2d 320, 213 N. E. 2d 677 (1965); remittitur amended, 17 N. Y. 2d 579 (1966).

Jurisdiction

The proceeding was brought under Article 78 (§§1283 to 1306 inclusive) of the New York Civil Practice Act, now Article 78 (§§7801 to 7806 inclusive) of the New York Civil Practice Law and Rules, to review two determinations of the Comptroller, both dated December 5, 1961. The judgment of the New York Court of Appeals here sought to be reviewed was rendered by remittitur dated December 30, 1965, as amended by an order of the Court of Appeals dated February 17, 1966 (Appendices B, C, pp. 35, 37). The notice of appeal (R. 566-571) was filed in the office of

the Clerk of the Supreme Court of the State of New York, County of New York on March 28, 1966.

Jurisdiction of this Court to review the decision of the Court of Appeals of the State of New York by direct appeal is found in Title 28, U. S. Code, §§1257(2) and 2101(c). Such jurisdiction is supported by: *J. D. Adams Mfg. Co.* v. *Storen,* 304 U. S. 307 (1938); *Freeman* v. *Hewit,* 329 U. S. 249 (1946); *Halliburton Oil Well Cementing Co.* v. *Reily,* 373 U. S. 64 (1963); and *King Mfg. Co.* v. *City Council of Augusta,* 277 U. S. 100 (1928).

Regulation and Statutes Involved

Involved in this appeal is the validity, under the Constitution of the United States, of a "Revised Allocation Formula" promulgated by "Bulletin 1955-2" of the Comptroller of the City of New York set forth in full in the Record (pp. 25-33 inclusive). The relevant portion of this Bulletin is set forth in Appendix D to this Statement.

A State statute, New York General City Law, §24-a, empowered the City of New York to impose a gross receipts tax, and contained a form of local law by which such power could be exercised. Section 2.b. of the form provided that where a receipt, otherwise taxable, could not in its entirety be subjected to the tax because of the provisions of the Constitution of the United States, the chief fiscal officer of the city "shall establish rules and regulations and/or methods of allocation and evaluation to the end that only that part of such receipt which is properly attributable and allocable to the doing of business in the city shall be taxed hereunder." The full text of §2.b. is set forth in Appendix E to this Statement.

The power conferred on the City was exercised by the enactment of Chapter 46, Title B, of the Administrative Code of the City of New York. Section B46-2.0.b. of that Title—set forth in Appendix F to this Statement—adopted in substantially identical language the provisions of §2.b. of the form contained in the State statute, and conferred the regulation-making power on the City Comptroller, the appellee here.

The Bulletin, containing the Revised Allocation Formula set forth in Appendix D, was promulgated by the Comptroller under that authority.

Questions Presented

New York City levies a tax on the gross receipts of those engaged in business in the City. Appellant's activities, during the years in question, included operation of three department stores in the City from which it sold goods—some in interstate commerce. The Comptroller's Revised Allocation Formula applied generally to all taxpayers, excluding only a few special categories. Its purpose was to allocate the proportion of receipts from transactions in interstate commerce, touching New York City, which may constitutionally be subjected to the tax.

Under the formula, assuming other factors remain constant, the tax on such interstate receipts increases as the taxpayer's wholly out-of-City receipts increase; likewise, the tax on interstate receipts decreases as the taxpayer's wholly in-State receipts from sales by New York City stores ("wholly taxable receipts") increase.

Thus, the tax penalizes interstate commerce by increasing its levy on interstate receipts as the taxpayer's wholly

out-of-City sales go up and as the taxpayer's wholly taxable receipts go down.

The validity of the Revised Allocation Formula, as applied to appellant, was upheld in the New York State courts.

The questions presented by this appeal are:

1. On its face, and as construed and applied to appellant, did appellee's Revised Allocation Formula, under which New York City's tax on gross receipts from interstate sales varies directly with the percentage of appellant's sales wholly outside the City and inversely with the percentage of sales by appellant's New York City stores wholly within the State, violate the Commerce Clause of the Constitution of the United States?

2. On its face, and as construed and applied to appellant, did that Revised Allocation Formula violate the Equal Protection Clause of the Fourteenth Amendment to the Constitution of the United States?

3. On its face, and as construed and applied to appellant, did that Revised Allocation Formula violate the Due Process Clause of the Fourteenth Amendment to the Constitution of the United States?

Statement of the Case

Federal Questions Raised

The federal constitutional questions presented by this appeal were raised at the hearing before the Comptroller (R. 115-116), and again in the petition to the New York Supreme Court seeking review of the Comptroller's determination (R. 19-22), and in the briefs to the Appellate Division of the New York Supreme Court and to the New York Court of Appeals. The appeal to the Court of Appeals was taken as of right upon federal constitutional grounds (R. 324). By amendment to the remittitur, the Court of Appeals held that (Appendix C):

> "Upon this appeal there were presented and necessarily passed upon questions under the Constitution of the United States, viz: The appellant argued that the formula under which the respondent, the Comptroller of the City of New York, allocated a portion of appellant's interstate receipts to be taxed by the City of New York, on its face and as construed and applied to appellant, violated the commerce clause of the said Constitution and the equal protection and due process clauses of the Fourteenth Amendment thereto. The Court of Appeals held that the said formula did not violate any of the provisions of the Constitution of the United States."

Facts

Appellant, a Delaware corporation with its principal office in Cincinnati, Ohio, operated forty-two department stores in eleven states during the years in question, 1953 to 1958 inclusive. It was qualified to do business in New

York, and it operated an Abraham & Straus and two Bloomingdale's stores in New York City from which it made sales of tangible personal property, some in interstate commerce.

Before 1953, New York City's gross receipts tax on receipts from interstate sales was computed, so far as it affected this appellant, under a so-called "Regular Allocation Formula" promulgated by the Comptroller in Article 21½, General Business and Financial Tax Regulations, Rules and Regulations of New York City Agencies, 1938-1946 Edition, pp. 79 *et seq.* This Regular Allocation Formula was essentially a three-factor formula giving equal weight to the geographical distribution of plant, payroll, and sales, and, except for certain built-in minima discussed below, was consistent with those applied in the vast majority of taxing jurisdictions using such formulae (cf. *General Motors Corp.* v. *District of Columbia,* 380 U. S. 553, 559 and note 9 (1965)).

The City's Regular Allocation Formula was struck down by the New York Court of Appeals in *Matter of Gulf Oil Corp.* v. *Joseph,* 307 N. Y. 342, 121 N. E. 2d 360 (1954),* because of built-in 33⅓ percent minima which, the court held, weighted the formula in the City's favor and placed it "out of harmony with the declared legislative purpose of taxing only that part of the interstate receipts which is properly attributable and allocable to the doing of business in the city." 307 N. Y. at 349, 121 N. E. 2d at 361-362. The court also held the formula invalid because "An unfair apportionment by one State could result in the risk of multiple taxation which would discriminate against petitioner as one engaged in interstate commerce." *Ibid.*

* Appeal on other grounds dismissed, 348 U. S. 923 (1955).

Instead of perfecting the formula simply by eliminating the minima denounced as invalid by the Court of Appeals, the Comptroller, on March 4, 1955, issued his Revised Allocation Formula, the constitutionality of which is here drawn in question. The new formula (Appendix D) was unique.*

It is not disputed that under the Revised Allocation Formula, assuming that all other factors remain the same,

1) As a taxpayer's wholly out-of-City receipts increase, the tax on interstate receipts increases;

2) As a taxpayer's wholly out-of-City receipts decrease, the tax on interstate receipts decreases;

3) As a taxpayer's New York City stores' wholly in-State receipts increase, the tax on interstate receipts decreases; and

4) As a taxpayer's New York City stores' wholly in-State receipts decrease, the tax on interstate receipts increases.

In the years here in question, 1953 to 1958 inclusive, appellant's New York City stores had gross receipts from sales rising from $137 million to $170 million. Over 95% of these receipts were wholly in-State and therefore taxable without dispute. Further, receipts from appellant's wholly out-of-City sales were treated as not subject to the tax and are not directly involved in this appeal.

Involved here are receipts from sales by appellant's New York City stores in interstate commerce in sums varying

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* Even now, only one other jurisdiction—the Philadelphia School District—employs such a formula, which it copied from New York City in 1956 (Regs. §404, CCH Pa. State Tax Rep. ¶169-226).

from $5,871,000 in 1953 to $6,723,000 in 1958, and as high as $7,442,000 in 1955. By applying his Revised Allocation Formula to these receipts, the Comptroller determined that percentages ranging from a low of 45.6% to a high of 48.7% of such stores' receipts from sales in interstate commerce, and varying in the bizarre manner described above, were subject to the tax.

Had the Comptroller applied to those receipts the usual three-factor formula and given equal weight to the geographical distribution of plant, payroll and sales, percentages ranging from a low of 24.4% to a high of only 27.8% of such receipts, and not varying in the peculiar manner described above, would have been taxed.

Holding of the Court of Appeals

The majority of the Court of Appeals, by a process of inductive reasoning, concluded that the Revised Allocation Formula was valid because "less than half of the allocable business attributed to sales made in New York resulting in out-of-State shipments are regularly attributed to the New York activity * * *" (Appendix A, p. 27; R. 561). It made no examination of the general effect of the formula and brushed aside the conceded fact that its operation was such that it exacted a penalty for increasing receipts from out-of-City sales and conferred a reward for decreasing such receipts (Appendix A, pp. 29-30; R. 562).

The majority thus noted only the ultimate percentage effect of the formula on this appellant's interstate sales, and, having found that it taxed less than half of appellant's receipts in interstate commerce, concluded that the formula must therefore be held to be fair.

On the other hand, Judge Van Voorhis, dissenting, found that:

"The fluctuations in the tax resulting from the application of this formula are unrelated to rational apportionment. There is no rational basis, as I view it, whereby the tax on interstate receipts can be increased as the taxpayer's wholly-out-of-city receipts increase, or whereby the tax on interstate receipts is increased if the taxpayer's wholly-in-city receipts decrease. Neither is there any rational relationship in the other enumerated applications of the formula.

"The majority opinion appears to recognize that the application of this formula to other types of business may prove to be arbitrary, and result in invalidity, but considers that (formulas aside) taxing 45% to 48% of the interstate sales of Bloomingdale's and Abraham & Straus is not unreasonable. Neither the Administrative Code nor the commerce clause nor the Fourteenth Amendment of the United States Constitution nor the New York State Constitution admits of assessing this tax on interstate sales against different businesses on a mere *ad hoc* basis. If that could have been done, the court would have held in *Gulf Oil Corporation* that however legally offensive the 33⅓% minimum might have been, recovery of 33⅓% would be allowed if it seemed fair to charge that amount against that taxpayer anyhow. In fact, under the Massachusetts-type [three-factor] formula, its percentages were 32.2%, 30.85% and 31.84% during the years involved.

"The validity of this formula has to be tested, it seems to me, on what can be done under it, not by whether we consider that the result reached would have been fair if some other kind of formula had been promulgated which would have come out the same way.

> The Court cannot decide the case on an *ad hoc* basis, it seems to me, any more than the City Comptroller could have done so by assigning to each taxpayer separately a percentage which, in his wisdom, he deemed should in the individual case be controlling in determining what proportions of interstate sales were subject to this tax, without prescribing any rules or regulations of general application as directed by subdivision b of section B46-2.0 of the Administrative Code" (Appendix A, pp. 33-34; R. 564-565).

The Federal Questions Are Substantial

The Court has only recently reiterated its "concern . . . that state taxes imposed on income from interstate commerce be fairly apportioned." It "has approved formulae based on the geographical distribution of corporate property and those based on the standard three-factor formula." *General Motors Corp.* v. *District of Columbia*, 380 U. S. 553, 560, 561 (1965).

In that case, the formula promulgated by the District Commissioners was struck down for failure to conform to the District enabling statute, and the Court therefore had no need to reach the constitutional questions presented. The substantial nature of those questions was, however, indicated by a comment of Mr. Justice Stewart (at pp. 556-557):

> "We are normally content to leave undisturbed decisions by the Court of Appeals for the District of Columbia Circuit concerning the import of legislation governing the affairs of the District. However, at times application of the District Code has an impact not confined to the Potomac's shores, but reaching far

beyond. This is such a case, for approval of the District Commissioners' regulations lends sanction to an apportionment formula seriously at variance with those prevailing in the vast majority of States and creates substantial dangers of multiple taxation. Where a decision is of such significance to interstate commerce, and where the result reached involves statutorily unsupportable exertions of administrative power, the traditional reasons underlying our customary refusal to review interpretations of District law do not apply."

Accepting the statement of the court below that "The power of taxation on the local activities of large enterprises ought not to be viewed narrowly (*Ford Motor Co.* v. *Beauchamp,* 308 U. S. 331)" (Appendix A, p. 28; R. 561), there remains the substantial federal question whether the New York City Comptroller, in imposing an apportionment formula seriously at variance with those prevailing in almost all other jurisdictions and thereby creating "substantial dangers of multiple taxation," has here been guilty of a *constitutionally* unsupportable exertion of administrative power, comparable to the *statutorily* unsupportable exertion of administrative power in *General Motors.* The dissenting judge in the Court of Appeals specifically found that the formula was unsupportable under the Commerce Clause and the Equal Protection and Due Process Clauses of the Fourteenth Amendment.

Cognizance of the substantial nature of the federal questions here presented has also been taken by the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the House of Representatives, established pursuant to Act of Congress ap-

proved September 14, 1959 (Public Law 86-272, §201), 73 Stat. 556, as amended. Volume 4 of the Report of that Subcommittee (89th Cong., 1st Sess., House Report No. 952) notes (at p. 1121) that, as of the end of 1964, gross receipts taxes were being imposed by over 1,000 localities.

Volume 3 of the same Report (89th Cong., 1st Sess., House Report No. 565) contains a study of the New York City formula here in question and, after pointing out the unconventional nature of the formula, states (p. 1088):

> "The complexity of the apportionment method used by New York * * * is not the only troublesome problem for interstate companies. Perhaps even more annoying is the fact that it tends to benefit locally based firms, since the greater the amount of receipts which are specifically allocated out of the city, the larger is the percentage of apportionable receipts attributed to the city."

On the same page of the Report, the Subcommittee, commenting on the formula of another jurisdiction, refers to it as "even more troublesome than New York's in the manner in which it discriminates against interstate commerce."

The New York City formula is at variance with those prevailing in almost all other states and localities, and thereby creates substantial dangers of multiple taxation. Its inherent design is such as to increase the tax on receipts from interstate commerce as out-of-City receipts increase and to decrease the tax as in-State receipts from sales by New York City stores increase. These aberrations raise substantial federal constitutional questions under the Commerce, Equal Protection, and Due Process Clauses, which should be resolved by this Court.

I.

The Comptroller's allocation formula, on its face and as here applied, violates the Commerce Clause of the United States Constitution.

1. *The formula is not a "fair method of allocation" and is discriminatory.*

The decision below sanctions an unconstitutional burden on interstate commerce, resulting in a pattern of arbitrary discrimination against this appellant and other taxpayers subject to the New York City gross receipts tax who engage in interstate commerce.

The City's formula violates the Commerce Clause in two respects. First, it is not the "fair method of apportionment," required by *Central Greyhound Lines, Inc.* v. *Mealey,* 334 U. S. 653, 663 (1948); and second, it is discriminatory because it levies an additional tax on interstate commerce measured by sales wholly outside New York.

As was conceded by the City and found by the New York Court of Appeals, the effect of the formula in question is to increase the tax as the taxpayer's out-of-State receipts increase. In this respect the City derives additional revenue as a direct result of an increase in an aspect of appellant's business which the City does not protect or service, and requires appellant's interstate commerce to do more than "pay its way." A formula such as this, which bases an increase in the tax on activities bearing no relation to New York, cannot be the "fair method of apportionment" contemplated by this Court's decisions in the *Central Greyhound* and other cases.

Discriminatory burdens on interstate commerce may take many forms. This Court has considered it its duty "to

determine whether the statute under attack, whatever its name may be, will in its *practical operation* work discrimination against interstate commerce," *Halliburton Oil Well Cementing Co.* v. *Reily,* 373 U. S. 64, 69 (1963) (emphasis added), quoting *Best & Co.* v. *Maxwell,* 311 U. S. 454, 455-456 (1940). Thus, discrimination against interstate commerce need not be as blatant as a direct tax or penalty on the commerce itself. It is sufficient if the *net result* of the tax is to impose a discriminatory burden. It is difficult to imagine a more injurious discrimination against interstate commerce than a local tax which increases its burden on such commerce in proportion to the amount of business transacted outside the State.

The burden on out-of-State activity is aggravated by the probability that when out-of-State sales increase, taxes in other states will increase. Thus, where out-of-State sales go up, both New York and other states' taxes may be expected to rise, creating a substantial danger of multiple taxation to which local commerce is not exposed. Such a risk of a multiple burden discriminates against interstate commerce. *Gwin, White & Prince, Inc.* v. *Henneford,* 305 U. S. 434, 439 (1939). As already noted, the Court's recent decision in *General Motors Corp.* v. *District of Columbia,* 380 U. S. 553, 559-560 (1965), indicates clearly that even a hypothetical danger of multiple taxation may render a tax allocation formula invalid.

In that same case, after deciding that the language of the enabling statute did not permit the apportionment formula in question, the Court concluded that "the result reached * * * is consistent with the concern which the Court has shown that state taxes imposed on income from interstate commerce be fairly apportioned." 380 U. S. at 560.

> "While the Court has refrained from attempting to define any single appropriate method of apportionment, it has sought to ensure that the methods used display a *modicum of reasonable relation to corporate activities within the State.*" 380 U. S. at 561. (Emphasis added.)

As the Court then made clear, a standard undistorted three-factor formula not only bears such a "reasonable relation", but is a method of apportionment to be preferred.*

In *General Motors,* the Court noted that its conclusion found support in the conflict with other taxing jurisdictions which would have resulted from approval of the District's formula (at p. 561) and from the "continuing concern for fair apportionment which this Court has displayed over the years in scrutinizing state taxing statutes" (at p. 562). In the cases in which that concern for fair apportionment has been displayed, the Court has always applied to state gross receipts taxes standards at least as stringent as those applied to state net income taxes.

Application of those standards to this case should result in striking down a formula by which a City penalizes interstate commerce by increasing the tax because there is an increase in sales in other states.

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* In fact, the District of Columbia Tax Commissioners, in response to the decision in *General Motors,* adopted the standard three-factor formula in effect in the majority of the jurisdictions which have adopted allocation formulae. CCH District of Columbia Tax Reporter ¶12-413.

2. *The City's allocation formula is repugnant to the rationale of prior Supreme Court decisions invalidating gross receipts taxes.*

In the leading case holding invalid an unapportioned tax on gross receipts, *J. D. Adams Mfg. Co.* v. *Storen,* 304 U. S. 307 (1938), the unapportioned tax had been levied on receipts from interstate sales of goods by an Indiana manufacturing corporation, all of whose properties were located in Indiana, 304 U. S. at 319 (Black, *J.*, dissenting), and nothing in the Court's opinion or the record indicates that there were any wages outside the State. The more recent decisions in *Freeman* v. *Hewit,* 329 U. S. 249 (1946), and *Indiana Department of State Revenue* v. *Nebeker,* 348 U. S. 933 (1955), also involved taxpayers with no out-of-State property or wages.

Since, in *Adams,* the total property and payroll of the taxpayer were attributable to the taxing jurisdiction, and the tax was still required to be apportioned, it follows that it is not a proper function of an allocation formula to determine what portion of the taxpayer's out-of-State property or payroll contributed to the creation of receipts from interstate sales. Yet this is the only asserted justification for the peculiarities of the City's formula. An allocation formula which, in the Comptroller's words, attempts to "eliminate from the property and wage factors any portions not properly attributable to the production of the allocable [interstate] receipts," Bulletin 1955-2 (Appendix D, p. 39) falsely assumes that it is relevant or permissible under the Court's decisions to adjust an allocation formula to limit the factors to the specific items which purportedly contribute to the earning of various types of receipts.

Such an assumption is even more clearly invalid when the effect of the formula is to increase the tax burden proportionately to an increase in wholly out-of-State activities. That result, in any event, "will in its practical operation work discrimination against interstate commerce," *Best & Co.* v. *Maxwell*, 311 U. S. 454, 456 (1940), and therefore runs afoul of the Commerce Clause.

II.

The allocation formula violates the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution.

Appellee's formula discriminates among taxpayers having equal amounts of wholly in-State and interstate receipts from sales by stores within the City. The basis for this discrimination—the amount of receipts wholly outside the taxing jurisdiction—is not rational, and so the formula denies to appellant the equal protection of the laws.

The tax involved here is "For the privilege of carrying on or exercising for gain or profit within the city any trade, business • • • or commercial activity • • •." New York City Administrative Code §B46-2.0.a.(1). Under the present allocation formula, if a competitor of appellant had property, wages and sales, both within and without New York, identical to appellant's, both corporations would pay the same New York City gross receipts tax. Assuming, however, that appellant's sales from its Cincinnati store went up because of increased advertising expenditures, while all other activities of both taxpayers remained static, appellant would then pay to the City a higher tax—from the attribution to the City of a larger percentage of ap-

pellant's interstate receipts—despite the absence of any increase in the New York City activities on which the tax purports to be levied.

"[A] statutory discrimination must be based on differences that are reasonably related to the purposes of the Act in which it is found." *Morey* v. *Doud,* 354 U. S. 457, 465 (1957). A tax that discriminates among competitive businesses of the same character, where there is no ground for difference having any relation to the object of the legislation, is invalid under the Equal Protection Clause. E.g., *Stewart Dry Goods Co.* v. *Lewis,* 294 U. S. 550 (1935); *Concordia Fire Ins. Co.* v. *Illinois,* 292 U. S. 535, 548-549 (1934).

The complicated adjustments of the City's formula were sought to be justified on the theory that it is necessary, in applying an allocation formula, to determine the portions of the property and wage factors outside the City which will go to the creation of allocable (interstate) receipts as distinguished from the portions "going into the creation of nontaxable [out-of-City] receipts" (R. 254). The formula then proceeds on the assumption that as out-of-City receipts increase "less of the out of city property and wages would be used because *theoretically* more of them were going into the creation of nontaxable receipts" (R. 254, emphasis added), and, therefore, less are attributable to receipts in New York from sales in interstate commerce.

The fallacy in these "theoretical" assumptions underlying respondent's formula is, as has been pointed out above (p. 17), that it is in no sense the proper function of an allocation formula to determine what specific portions of the total property and payroll of a taxpayer can be treated

as contributing to the creation of receipts from interstate commerce. The proper function is to determine what proportion of the total activities of the taxpayer may be attributed to the taxing jurisdiction as a measure of the receipts which may be taxed.

In the *Adams, Freeman* and *Nebeker* cases, the amount of the taxpayers' out-of-State property and wages contributing to the taxpayers' interstate receipts was clearly zero, so that application of the City's theory and its two-factor (property and wages) formula would have produced in those cases a full tax applied to 100% of the interstate receipts, a result which the Court held unconstitutional.

No rational basis, sufficient to meet the standards of the Equal Protection Clause, has been suggested to justify approval in this case of a formula inherently inconsistent with those three decisions. The City may not constitutionally "deem" out-of-City property to have contributed to the creation of appellant's interstate sales originating in the City, without also assuming that the same out-of-City property will contribute to the creation of its in-State sales originating in the City.* Pursued to its logical conclusion, the City's theory would require a taxpayer's property and wages within and outside the City to be attributed propor-

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* To illustrate the point, the Comptroller "deems" that appellant's property in Cincinnati contributes to the creation of sales by the New York City stores of goods shipped to New Jersey customers, but does not contribute to the creation of sales of goods shipped from New York City to other cities in New York State. Quite inconsistently, the Comptroller's Regulation assumes that none of appellant's New York City property makes any contribution whatever to the creation of sales of goods shipped from the Cincinnati store, to, for example, Covington, Kentucky.

tionately to the creation of all kinds of receipts. This would result in a formula free from unconstitutional discrimination.

The entire basis of the City's formula is thus exposed as irrational, and "not reasonably related to the purposes" of the taxing statute under which it was adopted.

The same conclusion is supported by the uncontradicted testimony of appellant's expert that it is not possible to attribute the earning of any particular type of receipts to any specified portion of appellant's property or wages (R. 113-114, 163, 262-263), so that each dollar of appellant's property and wages must be deemed to contribute proportionately to the earning of all its receipts.*

A stated corollary assumption underlying the City's formula is that, as nontaxable receipts increase, "the allocable [interstate] receipts would normally shrink as more effort was put into creating nontaxable receipts" (R. 254), because less property and payroll were being applied to their production. This corollary assumption is refuted by the facts of record in this case. Reference to Respondent's Exhibit D (R. 303) discloses that between 1953 and 1955 the percentage of appellants' property and wages outside

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* The court below noted that "Although the petitioner [appellant here] owns many department stores in other States, the contribution which these operations make to the sale of the three New York City stores of merchandise delivered to New Jersey and Connecticut is, so far as the record demonstrates, nil * * *" (Appendix A, p. 27; R. 560). The obvious reason for this lack of evidence was explained at the hearing (R. 113-114): that it is not possible to attribute the earnings of any type of receipts to any specified portion of appellant's property or wages. Therefore, the lack of any such evidence can in no rational way support the contention that the allocation formula, as applied to appellant, is "fair" or constitutional.

New York City remained substantially level (dropping slightly from 73.12% to 72.77%), while out-of-City receipts increased, both absolutely (from $327 million to $373 million) and relatively (from 70.45% to 71.33%). On the City's theory, appellant's interstate receipts should have decreased during this period. Instead, they increased, both absolutely (from $5,871,271 to $7,441,711) and relatively (from 1.26% to 1.42%). In addition, the percentage of interstate receipts allocated to New York City by the Comptroller's formula correspondingly increased from 46.92% to 48.74%. Thus, the facts in this very case further demonstrate the irrationality of the Comptroller's formula. They also show that the aberrant relationship between out-of-City receipts and the percentage of allocable receipts taxed is not in the case of this appellant merely theoretical, as suggested by the court below.

As the Court said in *Borden's Farm Prods. Co.* v. *Baldwin,* 293 U. S. 194, 209 (1934), immunity from constitutional assault is not "achieved by treating any fanciful conjecture as enough to repel attack." Here, the City's factual assumption as to the relation between out-of-City property and wages and appellant's interstate receipts was clearly refuted and no attempt was made to support it by any evidence. It therefore did not rise above the level of "fanciful conjecture." Thus, it is insufficient to sustain the formula against appellant's affirmative evidence of irrationality.

The fact that the court below impliedly accepted the "conjecture" of the appellee does not preclude this Court from reviewing its determination. As was said in *Fiske* v. *Kansas,* 274 U. S. 380, 385-386 (1927):

> "[The Supreme] Court will review the finding of facts by a State court where a federal right has been denied as the result of a finding shown by the record to be without evidence to support it; or where a conclusion of law as to a Federal right and a finding of fact are so intermingled as to make it necessary, in order to pass upon the Federal question, to analyze the facts."

See also *Norris* v. *Alabama,* 294 U. S. 587 (1935).

Since the object of the City's regulation is to tax the privilege of carrying on a trade or business within New York City, the discriminatory effect of taxing appellant at a higher effective rate than a taxpayer having equal interstate receipts, simply because appellant's out-of-City receipts are greater, demonstrates that the City's classification is unequal, arbitrary and capricious, and that the formula is therefore violative of the Equal Protection Clause of the Fourteenth Amendment.

III.

The allocation formula violates the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

As between two taxpayers having identical property, wages and receipts, within and without New York City, except for differing amounts of receipts from sales wholly outside New York City, the taxpayer having the greater out-of-City receipts will pay the greater tax under the City's formula. Such a taxpayer is in substance being taxed on business done outside the taxing jurisdiction, notwithstanding that the tax, in form, is measured by an in-

crease in the proportion of local stores' interstate sales subjected to the tax.

Such a tax on business done outside the taxing jurisdiction is invalid under the Due Process Clause, because a State or its subdivision lacks territorial jurisdiction to impose a gross receipts tax on activities of a foreign corporation carried on entirely outside its limits. *James* v. *Dravo Contracting Co.*, 302 U. S. 134 (1937). Cf. *McLeod* v. *J. E. Dilworth Co.*, 322 U. S. 327 (1944), as explained in *Miller Bros. Co.* v. *Maryland*, 347 U. S. 340, 345-346 (1954).

The tax, to be valid, must be properly apportioned to limit the tax to activities within the taxing jurisdiction. *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U. S. 123 (1931). This has not been done here. The tax formula therefore deprives petitioner of due process and must be struck down.

CONCLUSION

WHEREFORE it is respectfully submitted that this appeal in the above entitled cause comes within the proper jurisdiction of this Court.

WILBUR H. FRIEDMAN
and
GEORGE G. GALLANTZ
Counsel for Appellant

ROBERT J. LEVINSOHN
NEIL G. EPSTEIN
PROSKAUER ROSE GOETZ & MENDELSOHN
of Counsel

May 24, 1966

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APPENDIX A

The Majority and Dissenting Opinions of the Court of Appeals of the State of New York

Decided December 30, 1965

BERGAN, J. Petitioner is a Delaware corporation with a principal office in Cincinnati, Ohio, and operates 42 retail and specialty stores in 11 states. It owns three large department stores in New York City—an Abraham & Straus store in Brooklyn, the Bloomingdale's store in Manhattan and the one in Queens. Some of the business done in the three New York City stores is interstate. Deliveries are made to customers in New Jersey and Connecticut on sales made in New York.

In conformity with the authorization of section 24-a of the General City Law, the City of New York has enacted a General Business and Financial Tax Law which imposes an excise tax for the privilege of carrying on business in the city.

But since the city may not impose a tax on the entire interstate business done by a taxpayer (*Adams Mfg. Co.* v. *Storen,* 304 U. S. 307), the local law authorizes the Comptroller to prescribe a method of allocation of that portion of the interstate transactions which for local tax purposes are properly attributable to New York (Administrative Code of City of New York, § B46-2.0, subd. b). The Comptroller, with this purpose in view, has laid down a formula of apportionment (General Business and Financial Tax Regulations, Art. 211, § I, "Regular Allocation Formula").

An earlier method of allocation prescribed by the Comptroller was held invalid by this court in 1954 (*Matter of Gulf Oil Corp.* v. *Joseph,* 307 N. Y. 342). The basis for

decision was that the method established a minimum of 33⅓% in attributing interstate business to city activity. This the court ruled improper, i.e., "and we hold that the comptroller in using such minimum figures acted arbitrarily and out of harmony with the declared legislative purpose of taxing only that part of the interstate receipts which is properly attributable and allocable to the doing of business in the city." (p. 349).

Following this decision the Comptroller undertook to devise a new formula of allocation. He eliminated the absolute minimum which the court had held invalid. He prescribed a rather complicated scheme of allocation which weighs into consideration the total property and total wages within and without the city deemed to have produced the interstate business; the amount of wholly taxable business (that done in intrastate transactions); the amount of wholly untaxed business (that done outside the State), and the allocable business (that done in interstate commerce emanating from the city).

As applied to the petitioner's allocable interstate business emanating from New York City, this formula treats about 45% to 48% of the receipts from that business as taxable in New York in the years 1953 to 1959 which are the subject of the present article 78 proceeding to review the Comptroller's determination.

Petitioner vigorously attacks the formula and suggests that it is both unfair and unconstitutional. But when it is kept in mind that what the formula purports to do is to measure and apportion the share of the interstate business attributable to New York activity, its actual impact on this petitioner seems entirely reasonable.

Even interstate business "must pay its way" (*Postal Tel.-Cable Co.* v. *Richmond*, 249 U. S. 252, 259). The ultimate test of local taxability is whether the tax attaches or

not to activities "carried on within the state" (*Gwin, White & Prince, Inc.* v. *Henneford,* 305 U. S. 434, 439).

Any formula purporting to be general in application must use some artificial assumptions. Business enterprises differ greatly, and the activity in New York of a shoe manufacturing enterprise which manufactures in Virginia and sells in New York is different in the apportionment of its activity than a retail sales enterprise which does all the relevant selling in New York and is serviced in some managerial aspects in Ohio. The formula, however, must usually serve different kinds of enterprises. What the formula must offer is not perfection but a "rough approximation" of a just allocation (*Illinois Cent. R. Co.* v. *Minnesota,* 309 U. S. 157, 161; *Harvester Co.* v. *Evatt,* 329 U. S. 416, 422-423).

Although the petitioner owns many department stores in other States, the contribution which these operations make to the sale of the three New York City stores of merchandise delivered to New Jersey and Connecticut is, so far as the record demonstrates, nil; and while the policy-making and accounting, and other related control procedures pursued in the main office at Cincinnati undoubtedly play some part in the interstate activity of the New York City stores, the part played is not shown to have large significance in a fair allocation of the basic activity which produced the sales.

Thus, when the net result of the application of the formula, complicated though it may be, to the actual operation of the petitioner's activities in New York is that less than half of the allocable business attributed to sales made in New York resulting in out-of-State shipments are regularly attributed to the New York activity, no unfairness is demonstrated. The business of retail sales is a thing closely

related to the place where a store is. When sales are made, even to a customer who comes in from New Jersey or Connecticut, an activity in large part traditionally local exists.

Heavy reliance is put by petitioner on *General Motors* v. *District of Columbia* (380 U. S. 553). But decision there turned entirely on a statutory construction of the District of Columbia Code which the court held did not authorize the challenged allocation. The court expressly noted it did not reach the constitutional problem (p. 555). The power of taxation on the local activities of large enterprises ought not to be viewed narrowly (*Ford Motor Co.* v. *Beauchamp,* 308 U. S. 331).

The petitioner's attack on the formula of the Comptroller is essentially based on what could happen when it is applied under certain assumed situations, rather than on any unfair or unjust apportionment to the actualities of petitioner's business or to the petitioner's actual experience upon application of the formula. The argument of the city in this court that "the petitioner is not making any direct assertion that the formula has resulted in attributing an excessive share of the interstate receipts to New York City" and that "[i]t limits its attack to the nature of the formula, asserting that it is unusual in nature and contains arbitrary or unreasonable provisions" is not adequately met by petitioner.

The formula by which a percentage of allocation of interstate business to city activity is calculated is laid out in the Comptroller's regulations in this text:

> "(a) The Property Factor. A percentage is to be computed on the basis of a fraction.
>
> "The numerator is the value of so much of the property in the City as may be deemed attributable to pro-

ducing the allocable receipts. It is arrived at by taking such proportion of the property in the City as the allocable receipts bear to the sum of the allocable and the wholly taxable receipts. This eliminates from the property factor the portion of the property within the City attributable to producing wholly taxable receipts.

"The denominator is the value of so much of the property within and without the City as may be deemed attributable to producing the allocable receipts. It is arrived at by taking the sum of two figures. The first figure is the amount in the numerator. To this is added the proportion of the value of the property outside the City as the allocable receipts bear to the sum of the allocable and the non-taxable receipts, thus eliminating from the property factor the portion of the property outside of the City attributable to non-taxable receipts.

"(b) The Wages and Salaries Factor. A percentage is computed on the basis of a fraction arrived at by the same method as above, except that wages and salaries constitute the factor rather than property.

"(c) Add the above two percentages, divide by two, and multiply the allocable receipts by the result. Where the resultant average of the percentages exceeds 66⅔%, it shall be reduced to 66⅔% for the purpose of allocation. The product will be the portion of the allocable receipts to be included in the measure of the tax."

Petitioner's main argument for invalidity of this formula suggests that the tax tends to increase as a taxpayer's out-of-State and hence wholly nontaxable receipts increase when the relative amounts of property and wages are constant.

If one carries through calculations required by the formula, keeping the property and wages at the same level, this can be seen to be borne out.

The city argues, however, that it would not normally be expected that such an actual situation would occur. In spite of this theoretical possibility under the formula, the city contends that in its application to petitioner's business it falls within the test laid down in *Butler Bros.* v. *McColgan* (315 U. S. 501, 506) as a method "fairly calculated" to assign to New York the proportion reasonably attributable to business done there.

By way of illustration the city observes that, if all of the out-of-State property of petitioner were an Ohio store which had $9,000,000 in receipts and the allocable (interstate) receipts of the New York stores were $1,000,000, the formula would assume that one tenth of the property and wages of the Ohio store were devoted to creating the New York allocable receipts. If, with all wages and property unchanged, the Ohio store's receipts were increased to $19,000,000 while the New York allocable receipts remained at $1,000,000, the formula would assume that only one twentieth of the Ohio wages and property had been devoted to creating the New York allocable receipts.

"As a result", argues the city, "the New York City property and wages treated as creating the allocable receipts would become a larger proportion of the total property and wages treated as creating such receipts. * * * In a year when the New York City allocable receipts is a larger proportion of both types of receipts, the share of the Ohio property and wages attributable to the New York allocable receipts is greater. In a year when the New York City allocable receipts remain unchanged but the total of both types of receipts is increased because the Ohio sales have

increased, the share of the Ohio property and wages attributable to the New York City allocable receipts necessarily decreases."

Although the formula, which, as it has been noted, was written for many different types of businesses, treats the out-of-State property and wages as helping materially to create the New York allocable sales in a business such as petitioner's, the part actually played by the out-of-State activity in the creation of the allocable sales could be quite insignificant. Thus the city contends that the actual application of the formula "is over-generous to a taxpayer in petitioner's circumstances".

Whether it is overgenerous or not, its application is not demonstrated to be unfair or to represent an unreasonable thrust on the interstate activities of petitioner. There could well be circumstances where the formula, mechanically applied, would operate unfairly and impose too heavy a burden on interstate activities. To some extent the 66⅔% ceiling built into the formula would tend to avoid this.

Theoretical calculations under the formula can be pursued where the influence of out-of-State investment, wages and sales activity would be unfairly thrown out of focus as related to New York transactions to cast too heavy a burden on interstate activity. If such cases actually occur, the Comptroller has the power, and it would be his duty, to make adjustments which would keep the formula within a reasonable attribution to the local business activity in the city, by providing an alternative method of apportionment as article 210 of his published regulations allows. The petitioner has not demonstrated unfairness in the actual impact on it of the tax assessments of which it complains.

The order should be affirmed, with costs.

VAN VOORHIS, J. (dissenting). This appeal involves the validity of the allocation formula for the imposition of the New York City General Business and Financial Tax (a business privilege tax) on interstate sales—mostly to customers in New Jersey and Connecticut—made by Bloomingdale's department stores in Manhattan and Queens and by Abraham & Straus in Brooklyn. These are 3 of the 42 retail and specialty stores in 11 States owned by appellant Federated Department Stores, Inc. The tax is imposed under rules and regulations made by the Comptroller authorized by subdivison b of section B46-2.0 of the New York City Administrative Code, which provides that where a receipt in its entirety cannot be subjected to this tax by reason of the provisions of the Constitution of the United States (or any other provision of law) only that part of such receipt which is properly attributable and allocable to the doing of business in the city shall be taxed thereunder. A previous formula adopted by the Comptroller, known as a Massachusetts-type formula, was invalidated in *Matter of Gulf Oil Corp.* v. *Joseph* (307 N. Y. 342), for the reason that in preparing it the Comptroller departed from the customary method of allocation by providing that if the resultant average taxable percentage "is less than 33⅓% it shall be increased to 33⅓% for the purpose of allocation." The imposition of this minimum, without regard to whether it represented a fair allocation, was held to have been arbitrary and to subject the taxpayer to the risk of multiple taxation by other States. Instead of simply eliminating the minimum, a new formula was devised by the Comptroller, bearing merely superficial resemblance to the usual manner of allocation, which was designed to increase the tax by a method of apportionment which was fully as arbitrary as had been the illegal minimum.

The new formula is described in the majority opinion, and need not be repeated. The city admits at page 29 of its brief that the attack upon the formula by the petitioner is true, that assuming other factors remain the same:

"(1) As taxpayer's wholly out-of-City receipts increase, the tax on allocable (i.e., interstate) receipts increases;

"(2) As taxpayer's wholly out-of-City receipts decrease, the tax on allocable receipts decreases;

"(3) As taxpayer's wholly in-City receipts increase, the tax on allocable receipts decreases; and

"(4) As taxpayer's wholly in-City receipts decrease, the tax on allocable receipts increases."

The fluctuations in the tax resulting from the application of this formula are unrelated to rational apportionment. There is no rational basis, as I view it, whereby the tax on interstate receipts can be increased as the taxpayer's wholly-out-of-city receipts increase, or whereby the tax on interstate receipts is increased if the taxpayer's wholly-in-city receipts decrease. Neither is there any rational relationship in the other enumerated applications of the formula.

The majority opinion appears to recognize that the application of this formula to other types of business may prove to be arbitrary, and result in invalidity, but considers that (formulas aside) taxing 45% to 48% of the interstate sales of Bloomingdale's and Abraham & Straus is not unreasonable. Neither the Administrative Code nor the commerce clause nor the Fourteenth Amendment of the United States Constitution nor the New York State Constitution admits of assessing this tax on interstate sales against dif-

ferent businesses on a mere *ad hoc* basis. If that could have been done, the court would have held in *Gulf Oil Corporation* that however legally offensive the 33⅓% minimum might have been, recovery of 33⅓% would be allowed if it seemed fair to charge that amount against that taxpayer anyhow. In fact, under the Massachusetts-type formula, its percentages were 32.2%, 30.85% and 31.84% during the years involved.

The validity of this formula has to be tested, it seems to me, on what can be done under it, not by whether we consider that the result reached would have been fair if some other kind of formula had been promulgated which would have come out the same way. The Court cannot decide the case on an *ad hoc* basis, it seems to me, any more than the City Comptroller could have done so by assigning to each taxpayer separately a percentage which, in his wisdom, he deemed should in the individual case be controlling in determining what proportions of interstate sales were subject to this tax, without prescribing any rules or regulations of general application as directed by subdivision b of section B46-2.0 of the Administrative Code.

This formula, in my view, is invalid as contrary to that statute, and to the applicable provisions of the United States and New York State Constitutions.

The order of the Appellate Division and the determination of the City Comptroller should be reversed, and the matter remitted to the Comptroller for further proceedings.

Chief Judge Desmond and Judges Dye, Fuld, Burke and Scileppi concur with Judge Bergan; Judge Van Voorhis dissents in a separate opinion.

Order affirmed.

APPENDIX B

Remittitur of the Court of Appeals of the State of New York, dated December 30, 1965

BE IT REMEMBERED, That on the 7th day of June in the year of our Lord one thousand nine hundred and sixty-five Federated Department Stores, Inc., the appellant—in this case, came here unto the Court of Appeals, by Proskauer Rose Goetz & Mendelsohn, its attorneys, and filed in the said Court a Notice of Appeal and return thereto from the order of the Appellate Division of the Supreme Court in and for the First Judicial Department. And Lawrence E. Gerosa, as Comptroller of the City of New York, the respondent—in said cause, afterwards appeared in said Court of Appeals by Leo A. Larkin, his attorney.

Which said Notice of Appeal and the return thereto, filed as aforesaid, are hereunto annexed.

WHEREUPON, The said Court of Appeals having heard this cause argued by Mr. George G. Gallantz, of counsel for the appellant—, and by Mr. Stanley Buchsbaum, of counsel for the respondent—, and after due deliberation had thereon, did order and adjudge that the order of the Appellate Division of the Supreme Court appealed from herein be and the same hereby is affirmed, with costs.

And it was also further ordered, that the records aforesaid, and the proceedings in this Court, be remitted to the Supreme Court of the State of New York, there to be proceeded upon according to law.

THEREFORE, it is considered that the said order be affirmed, with costs, as aforesaid.

And hereupon, as well the Notice of Appeal and return thereto aforesaid as the judgment of the Court of Appeals aforesaid, by it given in the premises, are by the said Court of Appeals remitted into the Supreme Court of the State of New York before the Justices thereof, according to the form of the statute in such case made and provided, to be enforced according to law, and which record now remains in the said Supreme Court, before the Justices thereof, &c.

RAYMOND J. CANNON
Clerk of the Court of Appeals
of the State of New York

APPENDIX C

Order of the Court of Appeals of the State of New York, dated February 17, 1966, amending Remittitur

A motion to amend the remittitur in the above cause having heretofore been made upon the part of the appellant herein and papers having been submitted thereon and due deliberation having been thereupon had, it is

ORDERED, that the said motion be and the same hereby is granted, the return of the remittitur requested and, when returned, it will be amended by adding thereto the following:

> Upon this appeal there were presented and necessarily passed upon questions under the Constitution of the United States, viz: The appellant argued that the formula under which the respondent, the Comptroller of the City of New York, allocated a portion of appellant's interstate receipts to be taxed by the City of New York, on its face and as construed and applied to appellant, violated the commerce clause of the said Constitution and the equal protection and due process clauses of the Fourteenth Amendment thereto. The Court of Appeals held that the said formula did not violate any of the provisions of the Constitution of the United States.

AND the Supreme Court of New York County hereby is requested to direct its Clerk to return said remittitur to this Court for amendment accordingly.

A copy

GEARON KIMBALL
Deputy Clerk

APPENDIX D

Bulletin 1955-2 of the Comptroller of the City of New York

(See opposite) ☞

THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
BUREAU OF EXCISE TAXES
120 West 32nd Street
New York 1, N. Y.

BULLETIN

1955-2

SUBJECT: Revised Allocation Formulae for Apportionment of Receipts.

LAW: New York City General Business and Financial Tax Law (Sections B46-2.0 and B46-11.0 of the Administrative Code of the City of New York).

REGULATIONS: Articles 211, 213, 214, 225, 230, 249 and 250 of the Regulations pertaining to the General Business and Financial Tax Law, as amended.

RULING: The object of this bulletin is to prescribe revised formulae for apportionment of receipts from transactions involving interstate commerce with respect to persons who are engaged in business in the City of New York and whose receipts from interstate commerce are subject to tax on an allocable basis.

The general purpose of the formulae prescribed herein is to determine what portion of the allocable receipts may fairly be attributed to business conducted in the City and so be included in the measure of the tax. The formulae recognize the interrelationship between receipts, property and wages and utilize all three factors, but in the interest of accuracy, they eliminate from the property and wage factors any portions not properly attributable to the production of the allocable receipts. Thus, in applying to allocable receipts the ratio between property in and property outside the City (or wages in and wages outside the City) only the property or wages attributable to the allocable receipts is considered. By thus dealing with all three factors on the same basis, a fair apportionment of the allocable receipts is achieved.

I

ALLOCATION FORMULA FOR APPORTIONING RECEIPTS FROM THE SALE OF GOODS IN INTERSTATE COMMERCE

The regular allocation formula prescribed in Article 211 (I) of the Comptroller's Regulations is revised.

In applying the revised formula the following facts must be known (as defined or described in Article 211 of the Regulations):

1. The value of the property within and without the City.
2. The amount of wages and salaries in and out of the City.
3. The amount of wholly taxable receipts.
4. The amount of allocable receipts.
5. The amount of non-taxable receipts.

Receipts from foreign commerce are dealt with in subdivision II of this Bulletin.

The revised formula is as follows:

(a) The Property Factor. A percentage is to be computed on the basis of a fraction.

RULING: (Continued)

The numerator is the value of so much of the property in the City as may be deemed attributable to producing the allocable receipts. It is arrived at by taking such proportion of the property in the City as the allocable receipts bear to the sum of the allocable and the wholly taxable receipts. This eliminates from the property factor the portion of the property within the City attributable to producing wholly taxable receipts.

The denominator is the value of so much of the property within and without the City as may be deemed attributable to producing the allocable receipts. It is arrived at by taking the sum of two figures. The first figure is the amount in the numerator. To this is added such proportion of the value of the property outside the City as the allocable receipts bear to the sum of the allocable and the non-taxable receipts, thus eliminating from the property factor the portion of the property outside of the City attributable to non-taxable receipts.

(b) The Wages and Salaries Factor. A percentage is computed on the basis of a fraction arrived at by the same method as above, except that wages and salaries constitute the factor rather than property.

(c) Add the above two percentages, divide by two, and multiply the allocable receipts by the result. Where the resultant average of the percentages exceeds 66⅔%, it shall be reduced to 66⅔% for the purpose of allocation. The product will be the portion of the allocable receipts to be included in the measure of the tax.

Stated as a fraction the formula is as follows:

$$\text{Property in New York City} \times \frac{\text{Allocable Receipts}}{\text{Allocable and Wholly Taxable Receipts}} = \text{Numerator}$$

$$\text{Numerator plus } \left(\text{Property outside New York City} \times \frac{\text{Allocable Receipts}}{\text{Allocable and Non-Taxable Receipts}}\right) = \text{Denominator}$$

The fraction for the wages and salaries factor is computed in the same manner, except that wages and salaries are used rather than property.

APPENDIX E

New York General City Law § 24-a, § 2.b of Form of Local Law

Where a receipt in its entirety cannot be subjected to the tax imposed by this local law, by reason of the provisions of the constitution of the United States or any other provision of law, the chief fiscal officer shall establish rules and regulations and/or methods of allocation and evaluation to the end that only that part of such receipt which is properly attributable and allocable to the doing of business in the city shall be taxed hereunder. The chief fiscal officer may make such allocation, with due regard to the nature of the business concerned, on the basis of mileage, division of the receipt according to the number of jurisdictions in which it may be taxed, the ratio of the value of the property or assets of the taxpayer owned and situated in the city to the total property or assets of the taxpayer wherever owned and situated and/or any other method or methods of allocation other than the foregoing calculated to effect a fair and proper allocation in accordance with the purposes of this subdivision b.

APPENDIX F

Administrative Code of the City of New York, Chapter 46, Title B, § B46-2.0.b., as it read in 1955

Where a receipt in its entirety cannot be subjected to the tax imposed by this title by reason of the provisions of the constitution of the United States or any other provision of law, the comptroller* shall establish rules and regulations and/or methods of allocation and evaluation to the end that only that part of such receipt which is properly attributable and allocable to the doing of business in the city shall be taxed hereunder. The comptroller* may make such allocation, with due regard to the nature of the business concerned, on the basis of mileage, division of the receipt according to the number of jurisdictions in which it may be taxed, the ratio of the value of the property or assets of the taxpayer owned and situated in the city to the total property or assets of the taxpayer wherever owned and situated and/or any other method or methods of allocation other than the foregoing calculated to effect a fair and proper allocation in accordance with the purposes of this subdivision.

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* The subdivision has since been amended to replace the word "comptroller" in the indicated places with the words "director of finance". L. 1963, ch. 100, § 1595.

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JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

No. 171

FEDERATED DEPARTMENT STORES, INC.,

Appellant,

–v.–

LAWRENCE E. GEROSA, as Comptroller of The City of New York,

Appellee.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

MOTION TO DISMISS OR AFFIRM

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SAMUEL J. WARMS,
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

No. 71

FEDERATED DEPARTMENT STORES, INC.,

Appellant,

—v.—

LAWRENCE E. GEROSA, as Comptroller of The City of New York,

Appellee.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

MOTION TO DISMISS OR AFFIRM

Appellee in the above-entitled case, pursuant to a request of the Court transmitted by its Clerk, moves to dismiss or affirm the appeal on the ground that the questions presented are so insubstantial as not to need further argument.

Statement

This is an appeal from a final order of the Court of Appeals of the State of New York, dated December 30, 1965, affirming an order of the Appellate Division of the Supreme Court of that State.

The order upheld a tax deficiency assessed under the general business portion of the former New York City General Business and Financial Tax, a gross receipts tax for the privilege of doing business. The assessments were for the privilege periods from July 1, 1953, to June 30, 1959, measured by receipts for the calendar years 1953 through 1958, and are in the total amount of $55,210.50, inclusive of interest and penalty.

The issues raised relate solely to the validity of an allocation formula applied to interstate sales made by the New York City stores of the appellant.

Facts

(1)

The appellant is a Delaware corporation (R. 66-67). Its principal office is in Cincinnati, Ohio (R. 67). During the years in question it operated 42 retail department stores and specialty stores in eleven states (R. 68).

The appellant's New York City stores consisted of the Abraham & Straus store in Brooklyn and the Bloomingdale's stores in Manhattan and Queens (R. 68, 70). The Abraham & Straus division also operated three stores in the New York counties of Nassau and Suffolk (R. 68-69). The Bloomingdale's division also operated a store in New Rochelle, New York and one in Stamford, Connecticut (fols. 209-210).

The appellant's other stores were in Wisconsin, New Mexico, Texas, California, Massachusetts, Maine, Oklahoma, Ohio and Florida (City's Exhs. J-O, not printed).

(2)

The interstate sales involved in the present case were made by Bloomingdale's in Manhattan and by Abraham & Straus in Brooklyn. They normally were made to customers from New Jersey and Connecticut (R. 170, 182). The sales arose in one of three ways: the customer came into the New York City store to place the order, or the customer either mailed or telephoned the order to the store (*ibid.*).

Shipments of the articles ordered were by parcel post, United Parcel Service or express (R. 170). Payments were made through charge or credit accounts; by check, money order or cash; or by C.O.D. (R. 171). All moneys collected were remitted to the New York City stores (*ibid.*).

There was no participation in these sales by any out-of-State office of the appellant except its main office (R. 170-171). The main office in Cincinnati, Ohio, participated in the operation of the New York City stores, as well as in that of the other stores, by making policy decisions (R. 171-172). It provided advisory services in such fields as forecast of economic conditions, store organization and executive personnel, financial policies, taxes, insurance, etc. (R. 67). It also conducted special research studies on such matters as consumer credit selling, market analysis, store operations and methods of enhancing volume and profit (R. 68).

(3)

During the years in question the appellant's sales made at out-of-City stores ranged from $327,663,478 to $466,287,764 and constituted from about 70% to about 73% of its total receipts (Resp. Exh. D, R. 303). These

sales were treated as non-taxable and are not included in the tax base.

For the same years appellant's New York City stores made purely local sales ranging from $131,555,992 to $163,868,568, which constituted about 26% to 28% of its total sales (*ibid.*). These sales were treated as wholly taxable and the entire receipts from them are included in the tax base.

In these years the New York City stores' sales involving delivery to customers in other States ranged from $5,871,271 to $7,441,711 (*ibid.*). They constituted from 1.06% to 1.42% of the total receipts. New York City does not include all of these receipts in its tax base. It treats them as allocable receipts and applies its allocation formula to determine what portion of these receipts should be included in the tax base. The only issues in the case relate to the formula used for this purpose.

(4)

At the hearing appellant asserted and on appeal it has argued that a so-called Massachusetts three factor formula should have been used to determine the portion of the allocable receipts to be included in the tax base. Even the use of such a formula would have resulted in a substantial tax deficiency, approximately half of the deficiency found. On its tax returns the appellant, for all the years in question, treated only $3,487,852 of its allocable receipts as includable in the tax base (R. 35). The use of the Massachusetts formula as sought by appellant would have raised this amount to $10,375,917 (see amounts under Method 2 of Pet. Exhs. 46 and 47, R. 292). The City's formula raised this to $18,361,192 (R. 35). Thus, even the adoption of the Massachusetts formula for the allocable receipts would have resulted in a deficiency of principal of tax of approximately $17,000 for the years in question.

ARGUMENT

The claim that the New York City Comptroller's allocation formula violates the Commerce Clause, the Equal Protection Clause and the Due Process Clause of the United States Constitution does not present a substantial federal question.

The jurisdictional statement repeats arguments which are essentially the same with respect to each of the constitutional issues raised. To avoid repetition we shall deal with all of them under this single heading.

(1)

The appellant does not challenge the right of the City to include an allocated portion of the interstate receipts in the measure of the tax. It confines its attack to the allocation formula used to determine how much of such receipts should be attributed to New York City.

Moreover, the appellant does not have any sound basis for claiming that the portion of the receipts from interstate sales by its New York City stores attributed to that city is excessive. Nothing in the record even suggests that any store in any other State aids or contributes to the interstate sales here involved. No out-of-State office participated in these sales. Nor, aside from the fact that Bloomingdale's has a store in Stamford, Connecticut, and that all stores have executive and advisory services performed by the principal office in Ohio, is there any evidence that any other store, property or employee of the petitioner in any way contributes to the operation of any aspect of the petitioner's New York City stores or aids these local stores in obtaining their receipts or making their sales.

It is true that the appellant's assistant tax manager (referred to by appellant as its "expert") testified that it was not possible to attribute the earning of any particular type of receipt to any specified portion of its property or wages, but he never suggested in what way the property or wages of appellant's out-of-State stores did or could have contributed to the interstate sales made by the New York City stores.

Despite the extremely limited extent to which property, wages and activities of the appellant outside New York contributed to the production of the interstate receipts of the New York City stores, the City's allocation formula attributed only from about 45% to about 48% of these receipts to the New York City tax base for the various years in issue. It is, thus, plain that there is no basis for asserting that the formula has attributed to New York City more than a fair share of these receipts.

If a special formula were devised to deal with the actualities of the present case, the property and wages of the stores outside New York City would be completely disregarded since they in no way contribute to and have no relation to the receipts of the New York City stores. The only property and wages outside New York which would be considered would be that portion of the wages and the property of the principal office in Ohio which could be deemed attributable to the New York City stores and, possibly, a portion of the property and wages of Bloomingdale's Stamford, Connecticut, store. Such a formula would, in all probability, result in a percentage, not of 45% to 48%, but in excess of 90% to be attributed to New York City.

(2)

There is no merit to the suggestion that the City's formula is invalid simply because it is unique or because it is a two factor formula.

For many years allocation formulas have been used in applying property taxes, income taxes and franchise taxes to businesses that operate across State lines. These formulas have varied from the simple single factor mileage formula to complex multi-factor formulas.

For example, in imposing property taxes or taxes in lieu of property taxes, the percentage resulting from the single factor of mileage within the taxing state over total mileage has been applied to the property of transportation companies, usually after first deducting the separable localized property. *Nashville, C. & St. L. Ry.* v. *Browning,* 310 U. S. 362 (1940); *Ott* v. *Mississippi Barge Line,* 336 U. S. 169 (1949); *Railway Express Agency* v. *Virginia,* 358 U. S. 434 (1959). Similarly, franchise taxes on railroads have applied a mileage factor to the total gross receipts. *Maine* v. *Grand Trunk R'y Co.,* 142 U. S. 217 (1891).

Franchise taxes on capital stock have used a single factor formula of property and assets in the taxing state to all property and assets. *International Shoe Co.* v. *Shartel,* 279 U. S. 429 (1929). Another franchise tax was applied to capital stock, surplus and undivided profits plus long term obligations after using the single factor of gross receipts in the taxing state to all gross receipts. *Ford Motor Co.* v. *Beauchamp,* 308 U. S. 331 (1939). One franchise tax used a two-factor formula of property and business done. *Hump Hairpin Co.* v. *Emmerson,* 258 U. S. 290 (1922); *Western Cartridge Co.* v. *Emmerson,* 281 U. S. 511 (1930). Under another franchise tax the capital stock was divided in half and a property factor was used for one-half while a business done factor was applied to the other half. *International Harvester Co.* v. *Evatt,* 329 U. S. 416 (1947).

Franchise taxes measured by net income and net income taxes frequently use the so-called Massachusetts formula.

This formula employs the three factors of property, payroll and receipts. *Butler Bros.* v. *McColgan,* 315 U. S. 501 (1942). Other net income taxes substitute a manufacturing cost factor for the payroll factor or use only two of these factors or use the sole factor of sales receipts. See ALTMAN AND KEESLING, *Allocation of Income in State Taxation* (1946), pp. 129 *et seq.**

The aim of an allocation formula was well stated in *Ott* v. *Mississippi Barge Line,* 336 U. S. 169 (1949), where the Court said (p. 174):

> "The problem under the Commerce Clause is to determine 'what portion of an interstate organism may appropriately be attributed to each of the various states in which it functions.' *Nashville, C. & St. L. R. Co.* v. *Browning,* 310 U. S. 362, 365."

The nature of an allocation formula, however, is such that it cannot achieve precise results. In *Illinois Central R. Co.* v. *Minnesota,* 309 U. S. 157 (1940), the Court said (p. 161):

> "That the apportionment may not result in mathematical exactitude is certainly not a constitutional defect. Rough approximation rather than precision is, as a practical matter, the norm in any such tax system."

As a result, formulas have been upheld even where, unlike the formula here involved, they superficially appear to create unfair results. Thus, in cases involving franchise taxes measured by net income, the courts have upheld

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* "There is a tremendous diversity in types of formulas used. Indeed, no two taxing units use formulas that are alike in all respects. Different factors are used in the formulas; or else, when the same factors are employed, they are defined differently." MORSS, *Apportioning Corporate Income Among States for Tax Purposes,* 42 Taxes, No. 4, p. 261 (April, 1964).

formulas which attribute a portion of the net income to a State despite the fact that the evidence shows that the business actually done in that State resulted in a loss. *Butler Bros.* v. *McColgan,* 315 U. S. 501 (1942); *Bass, Ratcliff & Gretton* v. *State Tax Comm.,* 266 U. S. 271 (1924).

In *Ford Motor Co.* v. *Beauchamp,* 308 U. S. 331 (1939), an allocation formula using the single factor of gross receipts was employed as a measure of the share attributable to Texas in imposing a corporate franchise tax measured by the outstanding capital stock, surplus and undistributed profit of the corporation, plus its long term obligations. The formula was upheld despite the fact that the capital it allocated to Texas exceeded $23,000,000, while the value of all assets located in Texas was somewhat over $3,000,000 (308 U. S. at p. 334).

Only when there is "clear and cogent evidence" that the formula is attributing extraterritorial values to the taxing State will it be upset. *Hans Rees' Sons* v. *No. Carolina,* 283 U. S. 123 (1931). *Butler Bros.* v. *McColgan,* 315 U. S. 501, 507 (1942); *Railway Express Agency* v. *Virginia,* 358 U. S. 434, 444 (1959).

(3)

There is one major difference between the formulas we have just been discussing and an allocation formula to be used in imposing a privilege tax measured by gross receipts. Under a property tax, a franchise tax or a net income tax, the percentage arrived at by the allocation formula is normally applied to all of the property, all of the capital stock, all of the assets or all of the net income. Sometimes, usually under property taxes, purely local

elements are treated separately, but the percentage shown by the formula is applied to all the remaining property.

If a similar practice could be followed in imposing a tax measured by gross receipts, the adoption of an appropriate allocation formula would be comparatively simple. Any of a number of the commonly used formulas, including the three factor Massachusetts formula, could be used. Where a tax is measured by gross receipts, however, it seems dubious whether a company which operates in more than one State can be taxed by applying an allocation formula percentage to all of its gross receipts without regard to where or how they are derived. For example, if the allocation under such a formula resulted in taxing a portion of the total receipts which exceeded all of the New York City receipts, it would hardly seem proper for New York City to measure its tax in part by a portion of the petitioner's receipts from its Texas, California and other stores when there is nothing in this City or State which in any way relates to those receipts other than the fact that all of the stores are owned by a single corporation.

It would seem more fitting, if not imperative, that the New York City tax be measured solely by receipts of the New York City stores. In so limiting the measure of the tax no problem arises with respect to the receipts from the local stores' intrastate sales. All of these receipts are properly included in the tax base. The difficulty arises in determining how much of the local stores' receipts from sales it makes across State lines should be attributed to New York City and included in the tax base. This requires the use of an allocation formula.

The aim of the formula, however, differs from that of the formulas used for other taxes. Those formulas are designed to determine what share of the *entire* income, etc.

of a company is attributable to a particular taxing State. Under a tax measured by gross receipts the formula seeks to determine what share of a *portion* of the gross receipts is attributable to a particular taxing jurisdiction. The portion to which the formula is applied is that which comes from interstate sales or activities. It does not include all the interstate receipts; it includes only the interstate receipts directly related to that taxing jurisdiction.

In the present case we are not dealing with the allocation of *all* the interstate receipts of the petitioner. Receipts from interstate sales by petitioner's stores located outside New York City are not included in the measure of the tax. This being so, the sole issue is the extent to which the receipts of New York City stores from sales involving delivery to customers in other States are to be attributed to New York City.

The formula actually used was designed to cover many and varied circumstances. As a result, it treats a portion of all of petitioner's property and wages, including those of all of its stores, as contributing to the New York City interstate receipts. The net result of this is beneficial to the petitioner because it reduces the percentage of the receipts attributed to New York City.

(4)

We turn now to the actual New York City formula.* It is basically a two factor formula, using the factor of real and tangible personal property and the factor of wages and salaries. The element of receipts is used in the formula, but it is used merely to determine how much of

* The formula, as promulgated, is to be found at pp. 25 *et seq.* of the Record.

the wages and salary and how much of the property, within and without the City, should be deemed to have contributed to the New York City interstate receipts.

In the formula the New York City interstate receipts are referred to as allocable receipts; the New York City intrastate receipts are designated as wholly taxable receipts; and the receipts which have no direct relationship to New York City are termed non-taxable receipts.

The first step under the formula involves a determination of how much of the property of the taxpayer is deemed to have contributed to the creation of the New York City interstate receipts, that is, the allocable receipts; how much of this property is within and how much without the City; and the percentage that the portion within the City constitutes of all the property which contributed to creating these receipts.

The formula does not treat all of the New York City property as contributing to the creation of the allocable receipts. It regards the local property as having contributed to creating the intrastate or wholly taxable receipts as well as the allocable receipts. To determine how much of the New York City property shall be assigned to the allocable receipts, the value of all of this property is multiplied by a fraction. This fraction has as its numerator the allocable receipts and has as its denominator all of the New York City receipts (the allocable receipts plus the wholly taxable receipts). The result of this computation becomes the numerator of the property factor.

The denominator of the property factor is arrived at in a similar manner. The property outside New York City is multiplied by a fraction which has as its numerator the New York City allocable receipts and has as its denominator the same allocable receipts plus all of the non-taxable

receipts. The resulting figure is the portion of the out-of-City property deemed to have contributed to creating the allocable receipts. To this figure is added the property in New York City which also has been deemed to have contributed to creating those allocable receipts. The total is all of the property, in and out of the City, which is regarded as having created the allocable receipts. This total becomes the denominator of the property factor.

The ultimate fraction which results shows the ratio of the property in New York City devoted to creating the allocable receipts to all property devoted to creating such receipts.

This ratio or fraction, expressed as a percentage, is the property factor. It is designed to show what percentage of all of the property deemed to have contributed to the creation of the allocable receipts is property in New York City.

The wages and salary factor is established in precisely the same manner except that wages and salaries are used in place of property.

When both of the factors are established, the two percentages thus reached are added and then divided by two. The allocable receipts are multiplied by this final percentage to determine how much of the allocable receipts should be placed in the New York City tax base. It should be noted that, where the final formula percentage exceeds 66⅔%, it is reduced to that percentage, so that the maximum of the allocable receipts ever attributed to New York City is 66⅔%.

It was the application of this formula to petitioner's allocable (New York City interstate) receipts that resulted in attributing to this City approximately 45% to 48% of such receipts for the years in question. We have previ-

ously pointed out that, if a special formula had been devised to deal with the specific facts in the present case, it would have attributed a much higher percentage to New York City because there is no evidence which even suggests that any property or salaries and wages outside New York City contributed to creating these receipts aside from a portion of those of the executive office in Cincinnati and, possibly, a portion of those of Bloomingdale's Stamford, Connecticut store.

The formula meets the tests laid down by this Court in *Butler Bros.* v. *McColgan,* 315 U. S. 501 (1942), where a statement was made with regard to California's net income tax law which is equally applicable to the formula under consideration (p. 506):

> "We read the statute as calling for a method of allocation which is 'fairly calculated' to assign to California that portion of the net income 'reasonably attributable' to the business done there."

(5)

The appellant's attack on the formula rests almost entirely on the argument that a formula which can result in taxing a higher percentage of the New York City interstate receipts when the taxpayer's receipts from sources outside the City increase must be an unreasonable and invalid formula. It hinges this argument on a theoretical and unrealistic assumption that the out-of-City receipts would increase while property and wages, both within and without the City, and all other receipts would remain unchanged. Even accepting this assumption, we shall show that the argument is unsound.

In the Court below the appellant illustrated the argument by asserting that an increase in sales by its Columbus, Ohio, store to residents of that city can

have no effect on sales by the New York City stores to New Jersey customers. Yet, under the formula if there were such an increase in Ohio sales and no other changes, there would be an increase in the percentage of the receipts from the New York to New Jersey sales which would be subjected to the tax. This, urged the appellant, established the unreasonableness of the formula.

An analysis of the purpose and nature of the formula, however, shows that it is entirely reasonable and proper for the portion of the New York City allocable receipts included in the tax base to increase under these limited circumstances. The appellant forgets that a portion of the property of the Ohio store and a portion of the wages of the Ohio store have been treated as contributing to the creation of the New York City allocable receipts. This is true of a portion of all property and all wages of the petitioner outside New York City. The size of the portion of such property and such wages attributed to creating the New York City allocable receipts depends upon the ratio between the allocable receipts and all of the other receipts of these out-of-City stores unrelated to and untaxed by New York City. When everything else remains stable but the Ohio receipts increase, the formula assumes that a greater proportion of the Ohio property and wages was used to create the Ohio receipts and a lesser proportion of the Ohio property and wages was devoted to creating the New York City allocable receipts.

The appellant, we are sure, would concede that, where there is an actual reduction in the out-of-City wages and property while the City property and wages remain the same, it would be proper for a formula to increase the share of New York City allocable receipts to be taxed by this City. The formula follows the same principle. It assumes that the portion of the Ohio store's property and wages helping create interstate receipts for the New York

stores has decreased when the Ohio store has increased its local Ohio sales. It assumes this decrease on the theory, entirely appropriate for a formula, that property and wages outside the City contribute to creating all receipts in similar proportions. Thus, assuming that all the property and wages of the petitioner outside New York City were the property and wages of the Ohio store, that the New York City allocable receipts were $1 million and that the total receipts of the Ohio store were $9 million, the formula would assume that one-tenth of the property and wages of the Ohio store were devoted to creating the New York City allocable receipts. If, without any increase in property or wages, the total receipts of the Ohio store for the following year increased to $19 million while the New York City allocable receipts remained $1 million, the formula would assume that only one-twentieth of the Ohio property and wages were devoted to creating the New York City allocable receipts. As a result, the New York City property and wages treated as creating the allocable receipts would become a larger proportion of the total property and wages treated as creating such receipts.

If property and wages in Ohio help create New York City allocable receipts and also help create Ohio receipts and it is impossible to determine the precise extent of their contribution to the creation of each type of receipts, it seems perfectly proper to attribute the Ohio property and wages to each type of receipt depending upon the percentage which it constitutes of the total of both types of receipts. In a year when the New York City allocable receipts is a larger proportion of both types of receipts, the share of the Ohio property and wages attributed to the New York City allocable receipts is greater. In a year when the New York City allocable receipts remain unchanged but the total of both types of receipts is increased because the Ohio sales have increased, the share of the

Ohio property and wages attributable to the New York City allocable receipts necessarily decreases.

Perhaps the appellant's failure to understand why this should be so stems from the fact that the formula is overgenerous to a taxpayer in the petitioner's circumstances. In fact, the property and wages of petitioner's store in Columbus, Ohio, do not contribute in any way to creating the New York City allocable receipts. Nevertheless, the formula, being designed for varied types of businesses, treats the Ohio store's property and wages as contributing to these allocable receipts. If, in accordance with the actualities, the formula disregarded the Ohio store's property and wages in determining how much of the New York City allocable receipts should be attributed to New York City, the share attributed to New York City would be far greater than it ever can be as long as some of the Ohio store's property and wages are treated as helping to create these allocable receipts.

The propriety of the formula may be best illustrated by a simplified example in which the formula does not, to the same extent as in the present case, unduly favor the taxpayer. Suppose a firm has a factory and a sales office in Ohio and has a sales office and a warehouse in New York City. In one year the factory manufactures goods to be sold for $10 million. It sells $8 million in Ohio. The remaining $2 million are delivered to and sold from the New York City warehouse. Of these latter sales $1 million are to New York City customers and the other $1 million are delivered to New Jersey customers.

It would seem clear that, where a formula must be used, it would be proper to treat one-tenth of the property and wages in Ohio as having helped create the $1 million of New York City allocable receipts since the $1 million is one-tenth of all the receipts produced as a result of the

factory's activities. In fact, the New York City formula attributes slightly more than this to Ohio. It uses a subfraction which places the $1 million of these allocable receipts in the numerator and the same $1 million plus the $8 million of Ohio receipts in the denominator. The resulting fraction is one-ninth or approximately 11%. It further favors the taxpayer by applying this 11% to, not only the property and wages of the Ohio factory, but also the property and wages of the Ohio sales outlet.

Now, let us suppose that the following year the property and wages of this firm do not change, but that its factory doubles its production. There are now $20 million worth of goods to be sold. New York City makes exactly the same sales as the year before, but Ohio increases its sales to $18 million. It would seem plain that a lesser share of the Ohio factory was devoted to producing the goods which resulted in the $1 million of New York City allocable sales. That $1 million of goods constituted only one-twentieth of the total of $20 million produced by the factory. Therefore, it is proper to treat only 5% of the Ohio factory's property and wages as having been devoted to producing the goods which resulted in the $1 million of allocable receipts. The New York City formula generously increases this to approximately 5.26% and applies this percentage to all of the Ohio property and wages.

Since the factors in the formula consist of a fraction which has as its numerator the New York City property helping to create the allocable receipts and has as its denominator all property helping to create these allocable receipts and a similar fraction for wages, the denominator in each of these fractions will be smaller for the second year since the Ohio property and wages attributed to the creation of the Ohio receipts is greater in the second year. The net result is that the final fractions show the New York City property and wages attributed to creating the

allocable receipts as a larger percentage of the total property and total wages treated as having created such allocable receipts.

It is this increase of percentage that results in New York City taxing a greater share of the allocable receipts in the second year. We can see no justification for the argument that such an increase is unfair and arbitrary. It seems entirely fair to assume that, when the same property and wages produce $10 million worth of goods in one year and $20 million in the next year, a smaller portion of the property and wages were used to produce the $1 million worth in the second year than in the first year.

Reduced to its simplest form, what we are attempting to say is this: If a man who is paid $20 a day produces two articles in a day, $10 of his pay should be attributed to each article. If he increases his efficiency without an increase in pay and later produces four articles in one day, only $5 of his pay should be attributed to each article.

Moreover, under the circumstances posed by the appellant the use of the Massachusetts three factor formula, as generally used for income taxes, would also result in an increase of the New York City tax. Accepting the appellant's assumptions, two of the factors—property and wages—would remain unchanged. The third factor, receipts, would decrease since a lesser percentage of the increased total would be New York City receipts. When the percentages for the three factors were added and divided by three, the final formula percentage attributable to New York City would still be decreased; but the decrease would be only one-third of the receipts' percentage decrease. This final formula percentage, however, would be applied to the entire net income, including all of the increase of income resulting from the increased Ohio receipts. The result would be an overall increase in the amount of the New York City tax.

(6)

At pages 21 to 22 of its jurisdictional statement, the appellant argues that the facts in the record refute an assumption underlying the formula. The assumption is that, as a general proposition, if wages and property remain unchanged and out-of-City receipts increase, there would be a decline in New York City receipts, both interstate and intrastate. The appellant points out that, although between 1953 and 1955 its percentage of wages and property outside the City remained substantially level and its out-of-City receipts increased both absolutely and relatively, the New York City interstate receipts increased also both absolutely and relatively. The relative increases, however, are so small as to be essentially meaningless. The out-of-City relative increase was less than 1% and City interstate receipts relative increase was 12/100 of 1%.

In addition, an examination of Respondent's Exhibit D (R. 303), from which appellant drew its figures and percentages, shows that the total of the New York City receipts did decline relatively. During this two-year period the out-of-City receipts increased approximately 14% while the New York City receipts, both interstate and intrastate, increased less than 10%. The fact that one portion of the New York City receipts, the interstate receipts, happened to increase at a greater rate, does not refute the basic assumption on which the formula rests. Increased interstate advertising or innumerable other factors may account for this increase in the interstate sales. The facts, however, accord with the assumption that, where property and wages are not increased, an increase in out-of-City sales is likely to result in a concomitant decrease in New York City sales.

(7)

The appellant's suggestion that the formula creates a risk of multiple taxation is completely without basis. The only receipts subjected to the tax are those from the purely local sales of the New York City stores plus, pursuant to the formula, an allocated portion of the interstate sales made by those stores. The receipts of the out-of-City stores are not touched by the tax. Thus, the tax base is less than the total of the receipts of the New York City stores. The states into which delivery is made by the City stores could not tax any portion of the receipts from such sales. New Jersey has no basis for such a tax since appellant has no store or office in that State. Nor is there any indication that Connecticut could tax such receipts. There is no evidence that the branch store in that State contributes in any way to bringing about the sales of the City stores to residents of Connecticut.

What has just been said also disposes of the contention, at pages 23 to 24 of the jurisdictional statement, that the appellant is "being taxed on business done outside the taxing jurisdiction."

(8)

The discrimination argument advanced at pages 18 to 20 of the jurisdictional statement is merely a variation of appellant's basic argument. There is no improper discrimination involved in applying a higher allocation percentage to the interstate sales made from the City by one taxpayer who has less out-of-City property and wages contributing to such sales than to another who, having the same amount and kind of sales, has more out-of-City property and wages contributing to those sales.

The formula reasonably assumes that, when the property and wages contributing to the creation of receipts

do not increase and, nevertheless, such receipts do increase, a smaller proportion of such property and wages is attributable to each dollar of such receipts. As a result, when the out-of-City receipts increase without any change in property and wages and without a change in other receipts, a smaller proportion of the out-of-City property and wages is attributed to each dollar of sales which it is assumed to have helped create. Since it is assumed to have helped create, in addition to the out-of-City receipts, the unchanged amount of New York City interstate receipts, the proportion of out-of-City property and wages deemed to have helped create these receipts becomes smaller. The net result is that the amount of New York City property and wages contributing to the creation of these interstate receipts remains unchanged while the amount of out-of-City wages and property contributing to such receipts is reduced. Consequently, the amount of New York City property and wages contributing to create these receipts becomes a higher percentage of the total property and wages contributing to the creation of the New York City interstate receipts.

Furthermore, as has been pointed out, the Massachusetts formula, recognized by the appellant as valid, would in its normal application have resulted in an increased City tax under the same circumstances.

(9)

The appellant repeatedly refers to the case of *General Motors Corp.* v. *District of Columbia*, 380 U.S. 553 (1965). In that case this Court refrained from passing on the constitutional issues, confining itself to a determination that the method of allocation was not authorized by the tax law. Moreover, the formula involved was a single sales factor formula under an income tax which attributed 100%

of the income to the District of Columbia on sales made into the District even though the products sold were manufactured and the orders were received outside the District and the products were shipped to the customers from points outside the District.

The appellant places great emphasis on the cases of *J. D. Adams Mfg. Co.* v. *Storen*, 304 U.S. 307 (1938); *Freeman* v. *Hewitt*, 329 U.S. 249 (1946), and *Indiana Department of State Revenue* v. *Nebeker*, 348 U.S. 933 (1955).

In the *Adams* case it was held that, even where a manufacturing corporation has its office, its factory and all other property in the taxing State, its gross receipts from interstate sales could not be subjected to a privilege tax without apportionment. Although the case did not discuss the nature of the required apportionment, the appellant concludes that it bars the use of the City formula. The theory is that, since the *Adams* case seems to hold that receipts from interstate sales must be apportioned even though the taxpayer has no property and possibly no payroll outside the taxing State, "it follows that it is not a proper function of an allocation formula to determine what portion of the taxpayer's out-of-State property or payroll contributed to the creation of receipts from interstate sales" (Juris. Statement, p. 17). It is submitted that this is precisely the function of an allocation formula, and that nothing in the *Adams* case opinion suggests the contrary. The appellant's theory would invalidate most, if not all, allocation formulas.

The City's formula meets the requirement of the *Adams* case that receipts from interstate sales must be apportioned even in a situation where there are no out-of-City property or wages. It does this by providing that no more than two-thirds of the allocable (*i.e.* interstate)

receipts shall be taxed. Under any formula it would be necessary to apportion on an arbitrary basis except under a formula with a receipts factor which treats receipts from out-of-State sales as not attributable to the taxing State. Assuming that a Massachusetts type three factor formula so treated the out-of-State sales, the formula would always result in allocating at least two-thirds of the receipts to the taxing State. Where all of the receipts came from outside of the State, the factor percentages would be as follows: Property, 100%; wages, 100%; and receipts, zero%. These percentages when added together and divided by three would result in 66⅔%. If some of the receipts came from or were treated as receipts of the taxing State, the precentage would be higher. This being so, the New York City formula, which automatically deducts one-third of the allocable receipts, is always as favorable to the taxpayer as the most favorable result under a Massachusetts type three factor formula under the circumstances of the *Adams* case.

It is difficult to believe that the *Adams* case can reasonably be construed to invalidate, not only the City formula, but also the Massachusetts formula.

The *Freeman* v. *Hewitt* case invalidated a gross receipts tax on an interstate sale of securities. The receipts upon which the tax was imposed were not apportioned. There is much dispute as to whether the determination was based on the failure to apportion or on the ground that a gross receipts tax may not be imposed on any of the receipts from an interstate sale.

The appellant seems to treat this case as though it were based on the same grounds as the *Adams* case. If this is so, our answer to the *Adams* case argument is equally applicable to this case. If, however, the appellant is citing the case for the proposition that none of the

receipts from an interstate sale may be subjected to a gross receipts tax, our answer is that apportioned gross receipts taxes on interstate sales and other activities are being treated by this Court as taxable. In the recent case of *General Motors* v. *Washington*, 377 U.S. 436 (1964), this Court said (p. 440):

> "Nevertheless, as we have seen, it is well established that taxation, measured by gross receipts is constitutionally proper if it is fairly apportioned."

To the same effect are: *Berkshire Fine Spinning Associates* v. *City of New York*, 5 NY 2d 347 (1959), dism. for want of a substantial fed. qn. 361 U.S. 3 (1959); *Central Greyhound Lines* v. *Mealey*, 334 U.S. 653 (1948).

The third case relied on by the appellant, the *Nebeker* case, differs from *Freeman* v. *Hewitt* only in that the securities sold were in a margin account. This Court, without opinion, affirmed on the authority of *Freeman* v. *Hewitt;* and, therefore, what has been said concerning *Freeman* v. *Hewitt* is equally applicable to this case.

(10)

The reference by the appellant to criticism of the City's formula by a Congressional committee does not relate to its constitutionality and, therefore, is irrelevant. It may be noted that the same committee leveled somewhat similar criticism at the Massachusetts type three factor formulas [Report of Special Subcommittee on State Taxation of Interstate Commerce, Volume 1 (Union Calendar No. 635, House Report No. 1480), pp. 194, 414-416].

CONCLUSION

The appeal to this Court from the judgment of the Court of Appeals of the State of New York should be dismissed, or the judgment affirmed.

November 18, 1966.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 171

FEDERATED DEPARTMENT STORES, INC.,

Appellant,

—v.—

LAWRENCE E. GEROSA, as Comptroller of THE CITY OF NEW YORK,

Appellee.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

BRIEF IN OPPOSITION TO MOTION TO DISMISS OR AFFIRM

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Appellant's Statement as to Jurisdiction, filed more than six months ago, dealt with each of the arguments contained in the motion of the City of New York to dismiss this appeal or to affirm the judgment appealed from. We find it necessary, therefore, to add but a few comments in reply.

I.

The City concedes that its tax on interstate receipts increases as appellant's out-of-City business increases (R. 17-18, 48-49, 564; Statement as to Jurisdiction, App. A, p. 33). It attempts to justify this result by pointing to the so-called Massachusetts or three-factor formula, which,

it says, if applied to total receipts, would result in an increased City tax (Motion, pp. 19 and 22). But, unlike the Massachusetts formula, the City's tax on interstate receipts also increases as in-State sales decrease. Thus, the City's tax penalizes interstate commerce by increasing its levy on interstate receipts both as appellant's out-of-State sales go up *and* as appellant's in-State receipts go down. No decision of this Court approves such a tax.

None of the City's arguments directed to establishing some rational basis for its formula take account of this Court's "duty to determine whether the statute under attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce." *Halliburton Oil Well Cementing Co.* v. *Reily,* 373 U.S. 64, 69 (1963), quoting *Best & Co.* v. *Maxwell,* 311 U.S. 454, 455-456 (1940). We called attention to these decisions (Statement as to Jurisdiction, pp. 14-15), but the City has chosen to ignore them.

Appellant does not contend, as the City suggests (Motion, p. 21), that there is any risk of taxation by other states of the interstate receipts themselves. The City's discriminatory formula creates a risk of multiple taxation because it is probable that the increased out-of-State receipts, which increase the tax on interstate receipts under the City's formula, will be taxed by those other states.

It is no answer that the amounts or percentages involved are small in relation to total receipts (Motion, p. 20). The dissent below, noting that the majority had approved the tax here largely on the ground that the percentages involved appeared small, said that this was an insufficient justification for an unconstitutional result (Statement as to Jurisdiction, App. A, p. 33; R. 564). The City's motion

ignores the logical constitutional analysis of that dissent, and can find nothing in the majority opinion to refute that analysis.

If this appeal is dismissed or the judgment affirmed, this case will inevitably be cited as the only authority for the proposition that a local gross receipts tax on interstate commerce can vary directly with the percentage of a taxpayer's sales outside the State and inversely with the percentage of a taxpayer's sales within the State. Local taxation of interstate business, already terribly complex, would thereby be made more so. The subject has for years given Congress concern (Statement as to Jurisdiction, pp. 12-13) and New York City's gross receipts tax on interstate business has been singled out for adverse comment on this very ground (House Report No. 565, 89th Cong. 1st Sess., p. 1088 (1965)).

II.

The City betrays the fallacy underlying its effort to justify its formula at page 16 of its motion, where it is stated that the formula assumes "that property and wages outside the City contribute to creating *all* receipts in similar proportions" (emphasis added). If the formula did this and applied a consistent rule to in-City property and wages, there would be no constitutional infirmity, for an increase in out-of-City receipts would no longer increase the percentage of interstate receipts taxed. However, this is just the opposite of what the formula does.

In determining what property and wages enter into its allocation fraction, the formula "deems" that out-of-City property and wages contribute to wholly out-of-City sales and to interstate sales by in-City stores, but *not* to sales by in-City stores within the State. Inconsistently, in-City

property and wages are "deemed" to contribute only to sales by in-City stores, within and without the State (Statement as to Jurisdiction, App. D, p. 40). Thus, in arriving at the arbitrary assumptions underlying its formula, the City ignored the obvious circumstance that out-of-City property and wages have just as much connection with New York City intrastate receipts as they have with New York City interstate receipts, and, conversely, that in-City property and wages have just as much connection with wholly out-of-City receipts as out-of-City property and wages have with interstate receipts originating in the City.

The City argues at page 20 of its motion that the basic assumption of its formula is that, where property and wages are unchanged, an increase in out-of-City receipts is likely to result in a relative decrease in New York City sales, "both interstate and intrastate". However, the formula's assumption is that only New York City interstate receipts will decrease (R. 254).* The formula's underlying assumption could be a concomitant decrease in both New York City interstate and intrastate sales only if it deemed that out-of-City property and wages contributed not only to wholly out-of-City receipts and New York City interstate receipts, but also to New York City intrastate receipts. As we have said, the City's formula does not do this, and its failure to do so is what produces in practical operation the discrimination against interstate commerce we challenge.

The City cites no support, judicial, academic or evidentiary, for its assumption that particular property or wages

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* The City's formula then treats less of the out-of-City property and wages as applying to the interstate receipts, and thus increases the tax on the interstate receipts, with the result, to which this appeal is directed, that an increase in out-of-City sales produces a higher New York City tax on the interstate receipts.

can be attributed to one type of receipt and not to another. Appellant's expert testified that there is no basis for any such assumption (R. 113-114, 163, 262-263), the facts of this case refute the assumption (Exhibit D, R. 303; Statement as to Jurisdiction, pp. 21-22), and the City itself says that "Increased interstate advertising or innumerable other factors may account for this [the actual] increase in the [appellant's] interstate sales" (Motion, p. 20). We need not—and do not—concede that the assumption, even if valid, could justify the formula's discriminatory effect on interstate commerce. Shorn of the assumption, the City's motion apparently concedes that the formula cannot be sustained.

CONCLUSION

The issue presents a substantial federal question and, if the City's motion were to be granted, the confusion existing in the already jumbled field of local taxation of interstate business would be further confounded.

The decision below was wrong, it is repugnant to the controlling decisions of this Court and it is unsupported by the facts.

Wherefore it is respectfully submitted that the motion to dismiss this appeal or to affirm the judgment appealed from should be denied and that the Court should note probable jurisdiction of the appeal.

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December 5, 1966